

Executive Summary

Section 2207 of the Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan, 2004 (Public Law 108-106), requires the submission of a quarterly report to Congress outlining the current conditions for programs and initiatives supported by the appropriation dedicated to the Iraq Relief and Reconstruction Fund (IRRF). The Office of Management and Budget (OMB) submitted the first three quarterly reports to Congress, with the last OMB submission occurring July 2, 2004. Subsequent reports have been submitted by the Department of State, beginning October 5, 2004.

This quarterly update for October 2006 marks the end of three years during which the IRRF has served as the primary funding source for Iraq reconstruction and development. Most IRRF-funded major infrastructure projects will be completed by the end of 2006. Our IRRF-funded programs to help the Iraqis stand up the Iraqi army and police are nearing completion, with the Iraqi Security Forces Fund (ISFF) now providing assistance. As the transition towards Government of Iraq (GOI) leadership progresses, USG efforts will increasingly focus on assisting the GOI in developing the capability to efficiently leverage its own revenues and international donor assistance.

The Embassy is fully engaged in supporting Prime Minister Maliki's government as it works to overcome the significant obstacles ahead. Our capacity development programs are designed to help Iraqi leaders in building the national and provincial governments' ability to lead Iraq's transition to democracy and open markets. Significant challenges remain for Iraq as it undertakes renewed efforts to stabilize key Iraqi cities beginning with Baghdad. The Baghdad Security Plan (BSP) or Operation Together Forward II, began in August 2006. A combined Iraqi-U.S. effort to secure, hold, and rebuild Baghdad's most unstable neighborhoods, BSP synchronizes security operations with extensive employment generation programs.

IRRF programs continue to pay dividends in supporting Iraq's development, including improving the economic infrastructure, Iraqi Security Forces, and government capacity.

IRRF Program Summary

As of September 30, 2006 \$18.06 billion of the IRRF was obligated of \$18.45 billion, accounting for 98% of the fund. To date, \$15.9 billion has been disbursed in payments for completed work. At this point, the availability of unobligated IRRF funds has expired. About \$2 billion in obligated projects and training programs are underway, with work ongoing through December 2007. Approximately \$385 million was intentionally left to expire, and will be used for upward adjustments and limited in-scope changes to complete existing contracts. This report was delayed to permit thorough review of obligation data as of IRRF's September 30, 2006 close-out date.

Over the last quarter, 306 IRRF projects were completed, bringing the total of IRRF construction and non-construction projects completed since the fall of 2003 to 11,217. As of September 30, there are 875 IRRF projects and training programs remaining to be completed.

Highlights of projects completed this quarter include:

- Completed nine Gas-Oil Separation Plant (GOSP) rehabilitation projects in the south. These facilities have increased processing capacity by approximately 400,000 bpd of crude oil and deliver feed gas to the natural gas liquids and liquefied petroleum gas plants at North Rumaila and Khor Zubair (\$53 million).
- Completed hot gas path inspections of two Siemens V94.2 generators and combustion inspections on two other V94.2 generators at the Bayji Power Station. The work included the upgrades of two of the units' combustors, increasing output by 30 MW at a cost of \$58 million. The increased capacity will provide electrical power to an additional 27,000 Iraqi homes.
- Significant progress was made in improving the supply of clean potable water and reducing waste discharge. Completed projects this quarter include the water treatment plant designs for Najaf, Diwaniya, and Dukon-Sulaymaniyah (\$11.3 million); the Wahda/Wathba Water Supply project (\$23.5 million); the Basrah Sewerage plan (\$55 million); and construction of the Zafaraniyah main sewage collection system in Baghdad (\$22.5 million). These completed water projects have helped increase the total number of Iraqis with improved access to fresh water from 3.1 to 4.6 million.
- Completed construction of Special Police Regiment Facilities at Taji (\$44.7 million).
- Completed construction of military facilities in Samara, Hammal Al Ali, Taji, and Diwaniya, supporting a total of 2,000 Iraqi soldiers, with a total construction cost of \$24.8 million.
- Completed the construction of the Ministry of Electricity's Regional Wireless Communication Network, which provides an internal communications system using microwave and UHF, as well as integrating data and voice communications (\$5 million).
- Completed a series of improvements at the Baghdad International Airport (BIAP), including a \$7 million visual aids project to enhance commercial air service.

Over the Fourth Quarter of FY06, the Department of State continued to make use of the authority provided by Congress to address emerging needs through the reallocation of \$105 million in funding among projects and sectors. Two reallocations totaling \$42.5 million provided additional funding for electrical transmission and generation projects. A reallocation totaling \$13.6 million supported

enhancements to civil aviation facilities. On August 17, the Administration notified Congress of its intention to redirect a total of \$34.4 million to construction of the Basrah Children's Hospital. During the quarter, the Administration also notified Congress of its intention to reallocate \$11.75 million to private sector programs and \$2.55 million from various programs to support non-proliferation programs.

Government of Iraq: The second quarter

The nascent government of Iraq continued to assume a more substantive role in addressing the many problems facing the country as it attempts to overcome a persistent insurgency, sectarianism, decades of kleptocracy, and neglect of its strategic infrastructure that have left the economy broken. The second quarter of the Maliki government, which was approved by the Council of Representatives (COR) on May 20, saw the passage of the Fuel Liberalization bill in early September. The implementation of this bill should help to alleviate the critical shortage of refined fuels in the country. The COR also worked on a region formation law and an investment law.

During July-September, Iraq continued efforts to improve internal security. The Political Committee for National Security is now serving as a cross-sectarian advisory forum for government and party leaders. The first transition of a province to Provincial Iraqi Control (PIC) occurred with the hand over of security responsibility for Muthanna province from MNF-I to the Governor of Muthanna in July. The PIC transfer of Dhi Qar province followed in September. Over the coming months through the PIC process the GOI will assume a larger role in providing for its own security. We expect this transition process to accelerate in the coming months.

Since the Prime Minister's June 26 announcement of the National Reconciliation Plan, the 25-member National Reconciliation Commission has held two of the four planned conferences: the Tribal Conference on August 26 and the Civil Society Conference September 16-17. Participants in both conferences re-affirmed their support for national reconciliation efforts.

Moving into Fiscal Year 2007, we will focus effort on building the capacity of the GOI ministries to manage essential governmental functions. In particular, continuing difficulties in budget execution have become a critical obstacle in restoring essential services to the Iraqi people. More effective financial systems, improved budget planning, and streamlined contract procedures will be our primary areas of effort in this sphere in the coming months.

Supporting Iraqi Reconstruction Leadership

Key challenges to accelerating the Government of Iraq's reconstruction program include: security; technical capacity at the national and provincial levels in project delivery processes; contracting processes and policies; capital project budgeting and cash management; and inter-agency coordination.

The Embassy, in partnership with the GOI, has established a Joint Reconstruction Task Force (JRTF) which is focused on immediately helping Iraqi leaders complete key Baghdad projects in support of the Baghdad Security Plan. Simultaneously, the JRTF will review and recommend process improvements to streamline the current project delivery process. JRTF activities will be designed to provide mentoring and develop project delivery capacity at the national and provincial levels. The JRTF will work with the GOI on all aspects of project management, from scoping the work to requesting and evaluating contract bids, contractor selection, contract funding, and execution of the contract.

Capacity Development

Iraq's democratic consolidation and prosperity depend on the ability of Iraq's governmental institutions to execute their duties competently and administer to the needs of its citizens. As part of the Mission's National Capacity Development Initiative, the Ministerial Coordination Team (MCT), working closely with senior Iraqi ministry officials through Ministerial Advisory Teams (MATs), developed short-term capacity development programs to provide immediate help to the GOI in addressing key bottlenecks in public administration. We initially programmed five initiatives addressing budget execution, procurement reform, strategic planning, specialized ministerial technical assistance, and English language courses across ten key ministries and the Prime Minister's Office. We leveraged \$15 million in Iraq Relief and Reconstruction Funds to execute these programs. The MCT also targeted approximately \$45 million in 2006 Emergency Supplemental Economic Support Funds for execution in the next quarter, with emphasis on strengthening the capacity of the Prime Ministers Office on policy formulation, legislative drafting, inter-ministerial coordination, and improving provincial-central government relationships.

Also in this quarter, USAID launched a longer-term, self-sustaining, national capacity development program that focuses on strengthening and expanding Iraq's existing civil service training institutes in Baghdad and the provinces. In partnership with the Ministry of Planning and Development Cooperation, USAID will focus on core public administration functions: fiscal management, personnel management and administration, strategic planning, and information technology.

Security Transition

We continue to help train and equip the Iraqi Security Forces (ISF) to enable them to assume responsibility for Iraq's security, with \$4.66 billion disbursed of the total \$5.03 billion allocated. This process is producing results. In September, the MOD and the Joint Headquarters took command of two of the Iraqi Army's ten divisions, and Dhi Qar became the second province to transition to Iraqi security control. As the ISF stands up and achieves an acceptable level of training and readiness to begin to maintain public order, and as the institutions of government develop greater capacity, we will adjust our military presence and roles accordingly.

Provincial Reconstruction Teams (PRT) Moving Forward

The development of capable provincial governments is a key objective that will facilitate Iraqi self-reliance. PRTs continue to provide the most viable platform to assist the Iraqi government in developing the capacity of provincial governments as Iraq moves toward decentralization.

In September, new PRTs in Salah ad Din and Diyala joined PRTs in Anbar, Babil, Baghdad, Kirkuk, and Ninawa to complete the slate of seven U.S.-led PRTs. Coalition PRTs under the leadership of the UK and Italy and with U.S. participation continue to support engagement in Basrah and Dhi Qar provinces, respectively. We plan to open the Korean-led PRT in Irbil (representing the Kurdish Region) in the coming quarter.

We also continue to monitor and assess the performance of the PRTs both in their internal operations and in their ability to meet the objectives of their mission. Through these assessments we determine what adjustments may be required to ensure success of the effort. As a result of assessments conducted earlier this year, we have expanded the PRT staff to add additional expertise in the areas of economic development, agricultural development, public diplomacy, and the rule of law. These additions will substantially enhance the ability of the PRT to train, coach, and mentor provincial leaders across a broader range of subjects identified by PRT monthly functional assessments.

With the support of the U.S. PRTs, the Provincial Reconstruction Development Committees (PRDCs) have been able to follow an expeditious and transparent infrastructure project nomination process that has ensured Iraqi buy-in and effective project implementation in the provinces.

As part of its mission to strengthen decentralization, and thereby the Provincial Councils, the PRDCs have provided Iraqi officials at all levels of government with greater involvement in determining how USG assistance funds have been used for infrastructure development. Further, the PRTs have worked closely with provincial governments to enable them to program and implement projects more effectively with funds allocated by the central government. Primary among these funds are the \$2 billion in GOI reconstruction and development funds allocated to each province.

PRDC projects funded by IRRF dollars to date include 135 infrastructure projects throughout 15 provinces. Of these projects, 56 have been funded in the electrical sector and total over \$40 million. Fifty-five projects have been approved in the roads and bridge sector totaling nearly \$50 million and 24 projects have been approved in the water sector totaling over \$13.7 million. In total, \$103.5 million in IRRF funds have been dedicated to reconstruction projects identified, prioritized, and nominated by the PRDCs throughout Iraq.

Moving ahead into 2007, Economic Support Funds will support continued development of the capacity of the Provincial Councils to provide for the needs of their citizens and gain a stronger understanding of transparency, efficiency, and accountability.

Challenges

Overcoming past difficulties and completing the Basrah Childrens' Hospital (BCH) project remains an important objective for the U.S. Government. The hospital represents an important and visible commitment to meeting the needs of the region's population.

A key factor in the project's shortcomings has been in the day-to-day management of the contract and the nature of the "cost-plus" design/build contract. To strengthen on-the-ground oversight, the U.S. Army Corps of Engineers Gulf Regional Division (GRD) has been given responsibility for overseeing the completion of the hospital. GRD is well positioned to provide the appropriate level of quality assurance and construction management on this project. Under GRD management, a total of 136 out of the 240 projects planned in the Basrah governorate have been completed to date. Of these 136 projects, 84 or 62% have been completed ahead of schedule or on time, while 39 or 29% were completed behind schedule. GRD will establish an on-site Special Project Office to provide the schedule and management oversight that is required for a construction project of this magnitude.

Sole source contracting authorization was sought and received to allow for contract award prior to September 30. MIDCON, a Jordanian limited liability company, whose business portfolio includes hospital construction/renovations, electro-mechanical, and water and sewage projects, was awarded the contract to complete the project. The company has demonstrated experience constructing hospitals and other projects of similar size to BCH. MIDCON has a comprehensive system to manage project financial data, cash flow, banking requirements, equipment/materials, and subcontractor performance.

GRD has negotiated a firm, fixed price contract with MIDCON, thereby mitigating the potential of cost overruns in the completion of the project. Like all projects in Iraq, however, there is always a risk that costs will increase or funding from other sources to support the project will not become available.

Several major construction issues were identified at the Baghdad Police College, including failure of construction materials and systems. Corrections for known deficiencies have been underway since June 2006, at no expense to the U.S. Government. The plumbing and affected electrical work in all of the cadet barracks has been replaced and all affected rooms have been cleaned, repainted, and retiled prior to occupancy. All eight barracks have been completed and returned to service. Deficiencies in the six classroom facilities have been repaired and those buildings are also being fully utilized. In addition, an independent technical and health assessment of all contracted buildings and facilities was completed to address the impact of known issues and identify potential future issues. The results of this assessment have identified additional warranty items to be addressed. The schedule under development will ensure repair of all deficiencies while avoiding any impact on training schedules or student capacity at the academy. We anticipate warranty corrective actions will be complete in December 2006.

International Compact with Iraq

The Iraqi government and the United Nations launched the International Compact with Iraq initiative July 27, 2006 in Baghdad. The Compact will provide a framework for mutual commitments between Iraq and the international community in which Iraq will commit to assuring good governance, the protection of human rights, reforming its main economic sectors, and establishing the laws and institutions to fight corruption in return for financial, technical, and other forms of assistance. Moreover, the Compact will broaden the international base of support for Iraq's development and transition to self-reliance. More than 35 countries have already expressed their support for the Compact. On September 18, the UN and Iraq hosted a meeting on the margins of the UN General Assembly to update countries on progress in formulating the Compact. The Compact's Preparatory Group scheduled a meeting in late October designed to finalize the document in preparation for concluding the document by the end of the year.

Beyond IRRF

As we move beyond the execution period for IRRF, our efforts will increasingly shift from large infrastructure projects funded with U.S. Government assistance to employing Economic Support Funds and other forms of foreign assistance to:

- Build national and provincial governments' ability to lead Iraq's transition to democracy and open markets.
- Mobilize Iraq's resources for essential services through technical assistance, capacity development and partnering incentives.
- Stabilize communities through smaller scale essential services projects, infrastructure security and provincial development based on integrated military/civilian planning.
- Leverage contributions from other donors in the International Compact process.